

WORKFORCE SAFETY & INSURANCE

FINANCIAL STATEMENTS
JUNE 30, 2011 AND 2010

WORKFORCE SAFETY & INSURANCE

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CERTIFIED PUBLIC ACCOUNTANTS
AND CONSULTANTS

INDEPENDENT AUDITOR'S REPORT

Governor of North Dakota
The Legislative Assembly

The Board of Directors
Workforce Safety & Insurance
Bismarck, North Dakota

We have audited the accompanying financial statements of the business-type activities of Workforce Safety & Insurance, a department of the State of North Dakota, as of and for the years ended June 30, 2011 and 2010, which collectively comprise Workforce Safety & Insurance's basic financial statements as listed in the table of contents. These financial statements are the responsibility of Workforce Safety & Insurance's management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinions.

As discussed in Note 1, the financial statements present only Workforce Safety & Insurance and do not purport to, and do not, present fairly the financial position and results of the operations and cash flows of the State of North Dakota, in conformity with accounting principles generally accepted in the United States of America.

In our opinion, the financial statements referred to above present fairly, in all material respects, the respective financial position of the business-type activities of Workforce Safety & Insurance, as of June 30, 2011 and 2010, and the results of operations and cash flows thereof for the years then ended in conformity with accounting principles generally accepted in the United States of America.

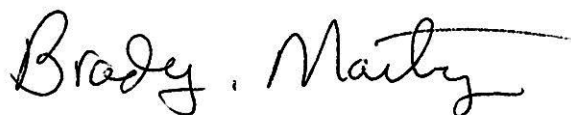
As discussed in Note 7 to the financial statements, there is a high degree of uncertainty in the estimated liability for unpaid loss and loss adjustment expenses recorded as of June 30, 2011, and 2010. Workforce Safety & Insurance has recorded the expected value of the liability as computed by its actuary; however, the ultimate liability may vary significantly.

As discussed in Note 1 to the financial statements, the Statement of Revenues, Expenses and Changes in Net Assets for the year ended June 30, 2010 has been changed to reflect the reclassification of \$74,868,560 of dividend credit expenses from an operating expense to a nonoperating expense. While this change is significant, it had no effect on Net Assets.

In accordance with *Government Auditing Standards*, we have also issued our report dated October 10, 2011, on our consideration of Workforce Safety & Insurance's internal control over financial reporting and our tests of its compliance with certain provisions of laws, regulations, contracts, grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audit.

Accounting principles generally accepted in the United States of America require that the management's discussion and analysis on pages 3 through 8 be presented to supplement the basic financial statements. Such information, although not a part of the basic financial statements, is required by the Governmental Accounting Standards Board, who considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic, or historical context. We have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the basic financial statements, and other knowledge we obtained during our audit of the basic financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

Our audit was conducted for the purpose of forming opinions on the financial statements that collectively comprise Workforce Safety & Insurance's financial statements as a whole. The loss development information and schedule of attorney fees and costs are presented for purposes of additional analysis and not a required part of the financial statements. These schedules are the responsibility of management and were derived from and relate directly to the underlying accounting and other records used to prepare the financial statements. The information has been subjected to the auditing procedures applied in the audit of the financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the financial statements or to the financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, the information is fairly stated in all material respects in relation to the financial statements as a whole.

A handwritten signature in black ink, reading "Brady, Martz". The signature is written in a cursive, flowing style.

BRADY, MARTZ & ASSOCIATES, P.C.

October 10, 2011

WORKFORCE SAFETY & INSURANCE

MANAGEMENT'S DISCUSSION AND ANALYSIS

JUNE 30, 2011, 2010 AND 2009

Workforce Safety & Insurance (WSI) was established in 1919 with the purpose of providing workers compensation insurance for employers, state agencies and other governmental units working in North Dakota. WSI operates in a manner similar to any other insurance company, but is also an agency of the State of North Dakota. As management of WSI, we offer readers of these financial statements a narrative overview and analysis of WSI's financial activities for the fiscal years ended June 30, 2011, 2010, and 2009. We encourage readers to consider the information presented here in conjunction with the entire financial statement package and the notes to those statements, which follow this section.

WSI is a proprietary fund and uses the accrual basis of accounting. A fund is a grouping of related accounts that is used to maintain control over resources that have been segregated for specific activities or objectives. WSI, like other state and local governments, uses fund accounting to ensure and demonstrate compliance with finance-related legal requirements. WSI is a special government reporting unit for the State of North Dakota and is combined with other similar funds to comprise the enterprise funds of the State of North Dakota.

Overview of Financial Statements

WSI's basic financial statements include the 1) balance sheet, 2) statement of revenues, expenses and changes in fund net assets, 3) statement of cash flows, and 4) statement of appropriations. The balance sheet provides readers the assets and liabilities of the fund, with the difference between the two considered net assets. It also provides the basis for determining the financial strength and solvency of the workers compensation fund. The statement of revenues, expenses and changes in fund net assets shows the operating performance of WSI for the fiscal year. The statement of cash flows identifies cash flows from operating activities, non-capital financing activities, capital and related financing activities, and investing activities. The statement of cash flows answers questions such as where did the cash come from, what was cash used for, and what was the change in the cash balance during the fiscal year. The statement of appropriations shows WSI's expenditures in relationship to the biennial appropriation approved by the 2009 Legislative Assembly.

WSI's notes to the financial statements provide readers additional information that is essential to a full understanding of the data provided in the fund financial statements. The notes can be found on pages 14-32 of this report.

In addition to the basic financial statements and accompanying notes, this report also presents certain required supplementary information concerning WSI's loss development and supplementary information concerning WSI's legal costs. This supplementary information can be found on pages 33 and 34.

Financial Highlights

While much of the nation is experiencing economic downturn, North Dakota's economy continues to grow. Fiscal year 2011 brought an influx of new business into North Dakota as evidenced by Workforce & Safety Insurance (WSI) writing \$6.2 million of new business for the second six months of fiscal year 2011, compared to \$6.9 million for all of fiscal year 2010. As Bakken oil began to flow, oil and related industry companies followed, generating \$3.5 million or 48% of all new business being associated with the petroleum industry.

WSI is also experiencing significant activity within the construction sector which generated \$1.7 million in premium or 27% of all new business. This trend will continue into fiscal year 2012 as a consequence of the severe flooding that has been experienced statewide. Starting in July of 2011, hundreds of flood recovery businesses began registering in the state to begin clean-up and restoration work which will result in additional premium.

MANAGEMENT'S DISCUSSION AND ANALYSIS

At June 30, 2011, and June 30, 2010, coverage extended to the following employers:

	2011	2010
Annual premium \$250 - \$5,000	16,105	15,629
Annual premium \$5,001 - \$50,000	4,574	4,168
Annual premium \$50,001 - \$100,000	380	345
Annual premium over \$100,000	316	286
Total policyholders	21,375	20,428

In fiscal year 2011, WSI added 947 policyholders, an increase of 4.6%. This increase is even more evident when compared to the relatively static policyholder numbers from 2009 (19,967), 2008 (19,886), and 2007 (19,672).

WSI continued to participate in the reinsurance market in 2011. WSI has three levels of reinsurance coverage in calendar year 2011 compared to two levels in calendar year 2010. More detail is provided in NOTE 8 – Reinsurance.

Condensed Statement Of Revenue & Expense

	2011	2010	2009
REVENUE			
OPERATING REVENUE			
Premium-net of discount and reinsurance premium	\$ 188,749,796	\$ 152,988,182	\$ 160,691,829
Subrogation, penalties and finance charges	3,396,746	3,470,640	2,393,898
Building rental revenue	710,286	710,081	759,180
Other revenue	293,308	541,427	12,876
NONOPERATING REVENUE			
Earnings (losses) on investments	164,103,773	131,239,065	(115,693,869)
Total revenues	357,253,909	288,949,395	48,163,914
EXPENSES			
OPERATING EXPENSE			
Incurred loss	168,548,565	117,606,375	147,080,241
Payroll and employee benefits	16,668,282	16,094,038	14,481,049
Other administrative expense	1,306,138	3,879,225	3,360,345
Bad debt expense	445,851	382,294	399,999
Depreciation expense	256,816	254,599	248,627
NONOPERATING EXPENSE			
Investment expense and other	5,105,379	5,206,073	6,332,254
Dividend expense	108,006,196	74,868,560	(3,300,000)
Total expenses	300,337,227	218,291,164	168,602,515
Change in net assets	\$ 56,916,682	\$ 70,658,231	\$ (120,438,601)

(continued on next page)

MANAGEMENT'S DISCUSSION AND ANALYSIS

WSI's financial position continues to remain strong. New and increased business activity in the state resulted in an increase of earned premium for fiscal year 2011. Earned premium net of discounts and reinsurance totaled \$188.8 million for fiscal year 2011. This is a 23% increase over fiscal year 2010's total of \$153 million, and a 17.5 % over fiscal year 2009's total of \$160.7 million. A decrease in premium discounts partially contributed to this increase. Premium discounts for fiscal year 2011 decreased to \$12.2 million dollars, compared to \$18.8 million in fiscal year 2010 and \$16.7 million in fiscal year 2009.

WSI's investment portfolio continued to show a comeback from the recession suffered globally in 2007-08. In fiscal year 2011, WSI's portfolio netted an annual rate of return of over 13%, bringing in over \$160 million of investment revenue. This compares to the annual rate of return in fiscal year 2010 and 2009 of 11.94% and (10.25%) respectively.

Investment earnings increased in fiscal year 2011 and 2010, after a significant decrease in fiscal year 2009.

WSI's annual rate of return as of June 30, 2011 was 13.26%, compared to 11.94% in fiscal year 2010 and a loss of (10.25%) in fiscal year 2009. WSI's average investment return for the five year period ending June 30, 2011 is 4.76% and the average ten year rate of return is 5.09%.

In fiscal year 2011, the WSI Board of Directors recommended a fifty percent dividend credit be issued for policies renewing in good standing, in accordance with NDCC 65-04-02. The Governor of North Dakota approved this recommendation. This dividend credit is estimated to be \$102 million. This is comparable to the 50% dividend credit declared in fiscal year 2010 which was estimated at \$76.5 million. This increase is attributed to the influx of business into North Dakota. End of year payroll adjustments affect prior estimated premium and these adjustments are trending upward. This increase resulted in a \$6 million increase in the dividend credit estimate from fiscal year 2010.

A dividend credit was not declared in fiscal year 2009, due to the economic condition of the investment markets and the overall economy in general. Even so, during the past seven years (2005-2011), WSI has declared over \$440 million dividend credits to North Dakota employers.

The 2009 Legislative Assembly revised the language regarding surplus requirements in NDCC 65-04-02, adding clarifying parameters for determining the amount of net assets, or surplus, to be considered available for dividend declaration. These changes went into effect August 1, 2009.

Incurred losses were \$168.5 million in fiscal year 2011, an increase of \$50.9 million or 43.3% more than the \$117.6 million booked in fiscal year 2010. Fiscal year 2010 resulted in a decrease of 20% or \$29.5 million less than the fiscal year 2009 total of \$147.1 million.

Total claims filed in fiscal year 2011, 2010, and 2009 were 21,693, 19,384, and 20,544 respectively. The number of active employer accounts has risen significantly in fiscal year 2011 due to the oil industry activity and North Dakota's overall strong economic standing. Total active employer accounts for fiscal year 2011, 2010, and 2009 were 21,552, 20,316, and 19,946 respectively. The fiscal year 2011 numbers reflect a 6.1% increase in policyholders.

The 2011 Legislative Assembly passed legislation increasing benefits in several areas. These increases are addressed in detail in Note 16 – Significant Legislative Changes.

Other administrative expense of \$1.3 million is a decrease of \$2.6 million or 66% less than the fiscal year 2010 total of \$3.9 million. This change in other administrative expense is mainly due to decreased expenditures in the area of safety grants and education. Total safety fund expenditures for fiscal year 2011, 2010, and 2009 are \$2, \$6.1, and \$4.4 million respectively.

MANAGEMENT'S DISCUSSION AND ANALYSIS

The fiscal year 2011 dividend credit is estimated at \$102 million dollars as previously discussed. The actual dividend expense for fiscal year 2011 was increased by the residual amount from the fiscal year 2010 dividend credit of \$6 million. The increased dividend expense in fiscal year 2011 reflects a revision made to the prior year's (fiscal year 2010) dividend estimate. WSI's policy billings are estimated annually based upon the prior year's estimated payroll. At the end of each year, payroll reports are submitted and reviewed for accuracy. The prior billing is then adjusted to reconcile with actual prior year payroll reports. As estimates are reconciled to actual amounts and premiums are adjusted, dividend estimates that were derived from estimated premium are also adjusted.

Investment and other expense has decreased year over year from fiscal year 2009 through fiscal year 2011. Most of this decrease goes hand in hand with the decrease of activity in the securities lending collateral segment of the portfolio. The June 30, 2011 amount for securities lending collateral is a mere \$12,070, reduced from \$7.3 million on June 30, 2010, and \$60.7 million on June 30, 2009.

Net assets as of June 30, 2011 total \$393.1 million, compared to \$336.2 million on June 30, 2010 and \$265.6 million on June 30, 2009. Net assets as of June 30, 2011 represent approximately 48.2% of the actuarial discounted reserve of \$814 million, compared to net assets as of June 30, 2010 which equal 43.5% of the actuarial discounted reserve of \$772 million and net assets of June 30, 2009 which equal 34.4% of the actuarial discounted reserve of \$772 million.

The 2009 Legislative Assembly revised the language regarding fund surplus requirements outlined in NDCC 65-04-02, adding clarifying parameters for determining the amount of net assets, or surplus, to be considered available for dividend declaration. This language allows funding for projects that have been legislatively and Board approved to be deducted from net assets to arrive at available surplus. Following these guidelines, the available surplus as of June 30, 2011 was \$366.7 million or 45% of the actuarial discount reserve of \$814 million. As of June 30, 2010 and June 30, 2009 the available surplus was 39.6% and 29.4% respectively.

Condensed Change in Net Assets

	<u>2011</u>	<u>2010</u>	<u>2009</u>
Beginning net assets	\$ 336,211,168	\$ 265,552,937	\$ 385,991,538
Change in net assets	<u>56,916,682</u>	<u>70,658,231</u>	<u>(120,438,601)</u>
Ending net assets	<u>\$ 393,127,850</u>	<u>\$ 336,211,168</u>	<u>\$ 265,552,937</u>

WSI's total assets as of June 30, 2011 totaled \$1.4 billion for an increase of \$131.9 million or 10.3% over total assets on June 30, 2010 of \$1.28 billion. Assets as of June 30, 2010 increased 8% or \$93 million over the fiscal year 2009 total of \$1.18 billion on June 30, 2009. These variances in total assets year over year are due to investment market fluctuations and the issuance of dividend credits. The difference between assets and liabilities is reported on the balance sheet as net assets, which are commonly referred to as fund surplus.

Requests for information

This financial report is designed to provide a general overview of WSI's finances. Questions concerning any of the information provided in this report or requests for additional financial information should be addressed to the Director of Finance, Workforce Safety & Insurance, 1600 East Century Avenue, Suite 1, Bismarck, ND 58503.

MANAGEMENT'S DISCUSSION AND ANALYSIS

	Condensed Balance Sheets		
	2011	2010	2009
ASSETS			
CURRENT ASSETS			
Cash and cash equivalents	\$ 1,668,707	\$ 1,364,416	\$ 2,030,233
Investments	1,343,817,539	1,204,687,355	1,075,741,662
Invested securities lending collateral	12,070	7,257,842	60,747,094
Premium receivables, net	28,154,597	31,890,987	15,826,326
Other accounts receivable, net	1,085,883	1,172,693	607,226
Investment interest receivable	7,141,600	7,858,153	8,521,532
Prepaid expenses	1,022,974	597,060	62,411
Total current assets	<u>1,382,903,370</u>	<u>1,254,828,506</u>	<u>1,163,536,484</u>
NON-CURRENT ASSETS			
Premium receivables, non current	730,164	1,223,751	1,307,358
Premises, furniture and equipment	24,155,357	19,852,300	17,680,467
Total assets	<u>\$ 1,407,788,891</u>	<u>\$ 1,275,904,557</u>	<u>\$ 1,182,524,309</u>
LIABILITIES			
CURRENT LIABILITIES			
Accounts payable	\$ 6,861,415	\$ 5,359,119	\$ 5,527,777
Unearned premium	91,586,519	78,320,109	77,004,241
Dividend payable	102,000,000	76,500,000	1,644,630
Securities lending collateral	12,070	7,257,842	60,747,094
Unpaid loss and LAE	101,750,000	96,500,000	96,250,000
Total current liabilities	<u>302,210,004</u>	<u>263,937,070</u>	<u>241,173,742</u>
NONCURRENT LIABILITIES			
Compensated absences, net	178,037	161,319	147,630
Unpaid loss & LAE, discounted at 5%	712,273,000	675,595,000	675,650,000
Total non-current liabilities	<u>712,451,037</u>	<u>675,756,319</u>	<u>675,797,630</u>
Total liabilities	<u>1,014,661,041</u>	<u>916,693,389</u>	<u>916,971,372</u>
NET ASSETS			
Invested in capital assets	24,155,357	19,852,300	17,680,467
Unrestricted	368,972,493	316,358,868	247,872,470
Total net assets	<u>393,127,850</u>	<u>336,211,168</u>	<u>265,552,937</u>
Total liabilities and net assets	<u>\$ 1,407,788,891</u>	<u>\$ 1,275,904,557</u>	<u>\$ 1,182,524,309</u>

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MANAGEMENT'S DISCUSSION AND ANALYSIS

Changes in net assets are the result of two separate activities or major program revenues: underwriting and investing. Underwriting activities measure annual premium revenues against claims costs and administrative expenses; while investing activities measure interest, dividends and changes in the fair value of WSI's investments. WSI's investing activities are designed to support its underwriting results and so, to the extent that investments appreciate in value, WSI can operate with an underwriting loss and still maintain its financial strength.

The change in net assets for fiscal year 2011 was a result of both underwriting and investment income. Fiscal year 2011 and 2010 present net asset increases of \$56.9 and \$70.7 million respectively, while fiscal year 2009 resulted in a decrease in net assets of (\$120.4) million.

Condensed Underwriting and Investment Analysis

	2011	2010	2009
Net premium earned	\$ 188,749,796	\$ 152,988,182	\$ 160,691,829
Incurred losses	157,355,838	106,767,781	137,523,405
Allocated loss adjustment expenses	4,021,205	3,946,309	3,305,031
Unallocated loss adjustment expenses	7,171,522	6,892,285	6,251,805
General and administrative expenses	18,677,087	20,610,156	26,625,099
Total losses and expenses	187,225,652	138,216,531	173,705,340
Underwriting income (loss)	1,524,144	14,771,651	(13,013,511)
Investment and other income (loss)	163,398,734	130,755,140	(110,725,090)
Dividend expenses	(108,006,196)	(74,868,560)	3,300,000
Change in net assets	\$ 56,916,682	\$ 70,658,231	\$ (120,438,601)

Capital Assets

WSI's non-current assets include land, the Century Center office building, furniture, equipment, and construction in progress assets that are not yet operational. The investment in capital assets increased in fiscal year 2011 as work continues on the software system replacement project and new work begins on the back-up generator system. On June 30, 2011, WSI's construction in progress account totaled \$13,927,716, comprised of \$13,907,916 for the software system replacement project and \$18,800 for the backup generator. This compares to \$9.4 million and \$7 million on June 30, 2010 and June 30, 2009 respectively. These assets will begin depreciating when they are placed into service. Expenditures for fiscal year 2011, 2010, and 2009 are \$4.5, \$2.4, and \$3.3 million respectively. A statement of changes in capital assets for fiscal year 2011, 2010, and 2009 can be found under Note 5 – Capital Assets.

Economic Factors and Next Year's Budget and Rates

WSI is a proprietary enterprise fund and does not receive any general fund dollars. Workers compensation premium and investment returns are the main sources of revenue. To ensure solvency of the fund, premium rates are actuarially established on an annual basis by external actuarial consultants. For policy year 2012, WSI anticipates statewide premium levels to increase by approximately 0.6%. This compares to the policy year 2011 increase of 3.3%.

WORKFORCE SAFETY & INSURANCE
BALANCE SHEETS
YEARS ENDED JUNE 30, 2011 AND 2010

ASSETS	2011	2010
CURRENT ASSETS		
Cash and cash equivalents	\$ 1,668,707	\$ 1,364,416
Investments	1,343,817,539	1,204,687,355
Invested securities lending collateral	12,070	7,257,842
Premium receivable, net	27,782,417	31,463,097
Est. retro policy premium receivable, current	372,180	427,890
Due from other state agencies	-	10,606
Other accounts receivable, net	1,085,883	1,162,087
Investment interest receivable	7,141,600	7,858,153
Prepaid expenses	1,022,974	597,060
Total current assets	<u>1,382,903,370</u>	<u>1,254,828,506</u>
NONCURRENT ASSETS		
Est. retro policy premium receivable, non-current	730,164	1,223,751
Land	901,974	901,974
Capital assets, net	9,326,667	9,524,341
Construction in progress	13,926,716	9,425,985
Total assets	<u>\$ 1,407,788,891</u>	<u>\$ 1,275,904,557</u>
LIABILITIES		
CURRENT LIABILITIES		
Accounts payable	\$ 5,650,946	\$ 4,366,105
Due to other state agencies	201,594	78,874
Unearned premium	91,586,519	78,320,109
Dividend payable	102,000,000	76,500,000
Compensated absences payable	1,008,875	914,140
Securities lending collateral	12,070	7,257,842
Unpaid loss and LAE	101,750,000	96,500,000
Total current liabilities	<u>302,210,004</u>	<u>263,937,070</u>
NONCURRENT LIABILITIES		
Compensated absences payable, net of current	178,037	161,319
Unpaid loss and LAE, discounted at 5%	712,273,000	675,595,000
Total non-current liabilities	<u>712,451,037</u>	<u>675,756,319</u>
Total liabilities	<u>1,014,661,041</u>	<u>939,693,389</u>
NET ASSETS		
Invested in capital assets, net of related debt	24,155,357	19,852,300
Unrestricted	368,972,493	316,358,868
Total net assets	<u>393,127,850</u>	<u>336,211,168</u>
Total liabilities and net assets	<u>\$ 1,407,788,891</u>	<u>\$ 1,275,904,557</u>

WORKFORCE SAFETY & INSURANCE
STATEMENTS OF REVENUES, EXPENSES, AND CHANGES IN FUND NET ASSETS
YEARS ENDED JUNE 30, 2011 AND 2010

	<u>2011</u>	<u>2010</u>
OPERATING REVENUES		
Net premiums earned	\$ 188,749,796	\$ 152,988,182
Penalties and finance charges	1,681,049	1,559,099
Third party subrogation recoveries	1,715,697	1,911,541
Rental operations	710,286	710,081
Miscellaneous	293,308	541,427
Total operating revenues	<u>193,150,136</u>	<u>157,710,330</u>
OPERATING EXPENSES		
Incurred losses	168,548,565	117,606,375
Payroll and benefits	16,668,282	16,094,038
Other administrative expenses	1,306,138	3,879,225
Bad debt expense	445,851	382,294
Depreciation expense	256,816	254,599
Total operating expenses	<u>187,225,652</u>	<u>138,216,531</u>
OPERATING GAIN	<u>5,924,484</u>	<u>19,493,799</u>
NONOPERATING REVENUES (EXPENSES)		
Interest and investment revenue	67,318,561	72,407,800
Investment expenses	(5,128,821)	(5,141,671)
Securities lending investment revenue	96,712	278,618
Securities lending expenses	23,442	(64,402)
Net increase in fair value of investments	96,688,500	58,552,647
Dividend credit expense	(108,006,196)	(74,868,560)
Net non-operating revenues	<u>50,992,198</u>	<u>51,164,432</u>
CHANGE IN NET ASSETS	56,916,682	70,658,231
TOTAL NET ASSETS, BEGINNING OF YEAR	<u>336,211,168</u>	<u>265,552,937</u>
TOTAL NET ASSETS, END OF YEAR	<u>\$ 393,127,850</u>	<u>\$ 336,211,168</u>

WORKFORCE SAFETY & INSURANCE
STATEMENTS OF CASH FLOWS
YEARS ENDED JUNE 30, 2011 AND 2010

	<u>2011</u>	<u>2010</u>
CASH FLOWS FROM OPERATING ACTIVITIES		
Receipts from employers	\$ 135,091,860	\$ 147,361,908
Receipts from other state agencies	2,643,228	2,067,070
Receipts from others	3,871,927	3,188,689
Payments to medical providers	(77,279,823)	(70,807,522)
Payments to injured workers	(47,953,349)	(45,206,766)
Payments to employers	(4,173,003)	(2,152,034)
Payments to employees	(12,283,255)	(11,808,275)
Payments to other state agencies	(1,870,640)	(1,746,010)
Payments to others	(13,415,845)	(16,452,254)
Net cash provided (used) by operating activities	<u>(15,368,900)</u>	<u>4,444,806</u>
CASH FLOWS FROM CAPITAL AND RELATED FINANCING ACTIVITIES		
Acquisition and construction of capital assets	<u>(4,559,873)</u>	<u>(2,426,432)</u>
CASH FLOWS FROM INVESTING ACTIVITIES		
Contributions to pooled investments	(8,266,936)	(24,284,191)
Withdrawals from pooled investments	<u>28,500,000</u>	<u>21,600,000</u>
Net cash provided (used) in investing activities	<u>20,233,064</u>	<u>(2,684,191)</u>
NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS	304,291	(665,817)
CASH AND CASH EQUIVALENTS, BEGINNING OF YEAR	<u>1,364,416</u>	<u>2,030,233</u>
CASH AND CASH EQUIVALENTS, END OF YEAR	<u>\$ 1,668,707</u>	<u>\$ 1,364,416</u>
SCHEDULE OF OTHER NONCASH ACTIVITIES		
Net increase in fair value of investments	\$ 96,688,500	\$ 58,552,647
Change in securities lending collateral	(20,828,822)	(53,489,252)
Investment income	62,229,231	67,537,881
Dividends credited to premium billings	82,506,196	82,820
Account receivable premium reductions	(82,506,196)	(82,820)

STATEMENTS OF CASH FLOWS

	<u>2011</u>	<u>2010</u>
RECONCILIATION OF OPERATING INCOME TO NET CASH PROVIDED (USED) BY OPERATING ACTIVITIES		
Operating income	\$ 5,924,484	\$ 19,493,799
Adjustments to reconcile operating income to net cash provided (used) by operating activities		
Depreciation expense	256,816	254,599
Dividend credits applied to receivables	(108,006,196)	(74,868,560)
Change in assets and liabilities		
Decrease (increase) in premium receivable	3,678,825	(15,767,215)
Decrease (increase) in retrospective premium receivable	549,297	(213,838)
Decrease (increase) in other accounts receivable	78,058	(556,718)
Decrease (increase) in due from other state agencies	10,606	(10,606)
Increase in prepaid expenses	(425,914)	(534,649)
Increase decrease in accounts payable	1,636,541	239,153
Increase (decrease) in due to other state agencies	122,720	(48,653)
Increase in dividend payable	25,500,000	74,855,370
Increase in unearned premium	13,266,410	1,315,868
Increase in compensated absences payable	111,453	91,256
Increase in unpaid loss and LAE	41,928,000	195,000
Net cash provided (used) by operating activities	<u>\$ (15,368,900)</u>	<u>\$ 4,444,806</u>

WORKFORCE SAFETY & INSURANCE
STATEMENT OF APPROPRIATIONS
YEARS ENDED JUNE 30, 2011 and JUNE 30, 2010

	Approved 2009-11 Biennial Appropriation	Expenditures 2010	Expenditures 2011	Unexpended Appropriation
APPROPRIATED EXPENDITURES	\$ 56,877,605	\$ 21,934,597	\$ 25,651,759	\$ 9,291,249
CONTINUING APPROPRIATIONS				
Performance evaluation		15,000	226,560	
Building operations		655,611	673,603	
Reinsurance		1,104,600	2,933,734	
Other states coverage		311,900	505,780	
Litigation collection costs		65,138	123,708	
Safety programs		6,180,590	2,085,155	
Preferred worker program		2,470	-	
Employer fraud		45,165	35,846	
Provider fraud		115,713	221,809	
Total*	<u>\$ 56,877,605</u>	<u>\$ 30,430,784</u>	<u>\$ 32,457,954</u>	<u>\$ 9,291,249</u>

*This total represents WSI's expenditures through the State Treasurer's Office using the State's PeopleSoft system. WSI has received an authorization from the State Treasurer's Office to also issue payments directly from the Bank of North Dakota; these payments include policyholder refunds, indemnity benefits, medical benefits, allocated loss adjustment expenses, and the educational revolving loan fund.

WORKFORCE SAFETY & INSURANCE
NOTES TO FINANCIAL STATEMENTS
JUNE 30, 2011

NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Financial Statements and Reporting Entity

Workforce Safety & Insurance (WSI) is an agency of the State of North Dakota, operating through the legislative authority of Title 65 of the North Dakota Century Code.

WSI was established in 1919 for the administration of the Workers Compensation Act and other designated acts. As a state agency, WSI is a department of the State of North Dakota and is included in the State's Comprehensive Annual Financial Report as an enterprise fund. The executive director of WSI is appointed by the Governor. Workforce Safety & Insurance provides no-fault medical and disability insurance to North Dakota employers. The state of North Dakota is a "monopolistic" state where WSI is the sole provider of workers compensation insurance. WSI is financed by premiums charged to employers doing business in North Dakota. The premiums are available primarily for the payment of claims to employees injured in the course of employment.

The accompanying financial statements of Workforce Safety & Insurance follow the pronouncements of the Governmental Accounting Standards Board (GASB), which is the nationally accepted standard-setting body for establishing accounting principles generally accepted in the United States of America for governmental entities. In accordance with Governmental Accounting Standards Board Statement No. 20, WSI follows all applicable GASB pronouncements as well as following Financial Accounting Standards Board pronouncements issued on or before November 30, 1989 unless those pronouncements conflict with GASB pronouncements.

For financial reporting purposes, WSI has included all funds and has considered all potential component units for which WSI is financially accountable, and other organizations for which the nature and significance of their relationship with WSI are such that exclusion would cause WSI's financial statements to be misleading or incomplete. The Governmental Accounting Standards Board has set forth criteria to be considered in determining financial accountability. This criterion includes appointing a voting majority of an organization's governing body and (1) the ability of WSI to impose its will on that organization or (2) the potential for the organization to provide specific financial benefits to, or impose specific financial burden on WSI.

Based upon these criteria, there are no component units to be included within WSI as a reporting entity and WSI is an agency within the State of North Dakota as a reporting entity.

Fund Financial Statements

WSI uses a fund to report financial position and operational results. Fund accounting is designed to demonstrate legal compliance and to aid financial management by segregating transactions related to certain government functions or activities. A fund is a separate accounting entity with a self-balancing set of accounts.

The financial activities of WSI reported in the accompanying statements are classified into one fund category, the proprietary fund. The proprietary fund includes the Enterprise Fund, which is used to account for the operations of the workers compensation insurance program for North Dakota employers and employees.

Proprietary funds distinguish operating revenues and expenses from non-operating items. Operating revenues and expenses generally result from providing services and producing and delivering goods in connection with a proprietary fund's principal ongoing operations. The principal operating revenues of WSI are premiums charged to policyholders for workers compensation insurance. WSI also recognizes as operating revenues, penalties and interest billed for delinquent premium, as well as third party liability subrogation recoveries.

NOTES TO FINANCIAL STATEMENTS

Operating expenses include incurred losses, payroll and benefits, other administrative expenses, bad debt expense and depreciation on capital assets. All revenues and expenses not meeting this definition are reported as non-operating revenues and expenses.

Measurement Focus, Basis of Accounting and Financial Statement Presentation

The accounting and financial reporting treatment applied to a fund is determined by its measurement focus. Proprietary funds are accounted for on a flow of economic resources measurement focus. This measurement focus includes all assets and liabilities associated with the operations of these funds on the balance sheet.

Proprietary funds are accounted for using the accrual basis of accounting. Under the accrual basis of accounting, revenues are recognized when they are earned and expenses are recognized when the related liability is incurred.

Proprietary funds distinguish operating revenues and expenses from non-operating items. Operating revenues and expenses generally result from providing services and producing and delivering goods in connection with a proprietary fund's principal ongoing operations. The principal operating revenues of the enterprise fund are premiums earned. Operating expenses for the enterprise fund include the incurred losses, payroll and benefits, other administrative expenses, bad debt expense and depreciation on capital assets. All revenues and expenses not meeting this definition are reported as non-operating revenues and expenses.

Budgetary Policies and Procedures

WSI operates through a biennial appropriation provided by the State Legislature. WSI prepares a biennial budget for administrative expenses which is included in the Governor's budget and is presented to the General Assembly at the beginning of each legislative session. The General Assembly enacts the budgets of the various state departments through passage of specific appropriation bills. Before signing the appropriation bills, the Governor may veto any specific appropriation, subject to legislative override. Once passed and signed, the appropriation becomes WSI's administrative budget for the next two years. Any changes to the budget appropriation require Emergency Commission authorization. The Legislative Assembly approved a single-line appropriation for WSI beginning with the 2001-2003 biennium.

The Emergency Commission can authorize receipt of federal or other moneys not appropriated by the Assembly if the Assembly did not indicate any intent to reject the money. The Emergency Commission may authorize pass-through federal funds from one state agency to another. Unexpended appropriations lapse at the end of each biennium.

The State of North Dakota does not formally budget revenues, thus, a Statement of Revenues, Expenditures, and Changes in Fund Net Assets - Budget and Actual cannot be prepared as required by accounting principles generally accepted in the United States of America. In its place a Statement of Appropriations has been presented. The Statement of Appropriations has been prepared using the modified accrual basis.

Cash and Investments

Cash and cash equivalents for reporting purposes, includes cash and short-term, highly liquid investments that are readily convertible to known amounts of cash and so near their maturity that they present insignificant risk of changes in value because of changes in interest rates. This includes investments with original maturity of three months or less. Investments are stated at fair value. Fair value is, "the amount that a plan can reasonably expect to receive for an investment in a current sale between a willing buyer and a willing seller - that is, other than a forced liquidation sale." Fair value was determined by reference to published market data for publicly traded securities or through the use of independent valuation services and appraisers for other investments.

NOTES TO FINANCIAL STATEMENTS

Net appreciation (depreciation) is determined by calculating the change in the fair value of investments between the end of the year and the beginning of the year, less any purchases of investments at cost, plus sales of investments at fair value. Investment expense consists of those administrative expenses directly related to the Retirement and Investment Office investment operations.

WSI's investment policy allows investment managers to use derivative securities. Managers are specifically permitted to use Treasury futures and options, S & P 500 index futures and options, and currency forwards and futures to hedge portfolio risk, but not to speculate or to leverage the portfolio. Managers may use their discretion to use other derivatives to enhance returns, reduce risk, or facilitate the management of index funds. WSI's policy with respect to these derivatives is that their use may not increase the credit, market or legal risk level associated with a fully invested portfolio of common stocks or fixed income obligations, depending on the manager's designated role.

As the master custodian for the Retirement and Investment Office, Northern Trust is the Agent of Record for WSI's portfolio.

Premium Receivable

Premium receivables are stated net of allowance for doubtful accounts in the amount of \$500,000 at June 30, 2011 and 2010. The receivables also include an estimate of premiums that have yet to be billed at year-end, but will be billed in subsequent periods.

Retrospective Premium Receivables are adjusted each year in accordance with the policy.

Other Accounts Receivable

Other accounts receivable consists of medical assessments, deductibles, reinsurance receivable on loss payments, receivables resulting from overpayments on claims, and other miscellaneous receivables. These receivables are stated net of allowance for doubtful accounts in the amount of \$4,000,000 at June 30, 2011 and 2010.

Prepaid Expenses

Payments made to vendors which exceed \$12,000 per year, for services that will benefit periods beyond June 30, 2011 and 2010 are recorded as prepaid expenses.

Capital Assets and Depreciation

All capital assets are recorded in the accompanying financial statements at cost. WSI capitalizes equipment costing over \$5,000 in accordance with section 54-27-21 of the North Dakota Century Code.

WSI's fixed assets are being depreciated on a straight-line basis over estimated useful lives ranging from 3 to 50 years.

Due to Other State Agencies

During the course of operations, numerous transactions occur between other state agencies for goods provided or services rendered. These payables are classified "Due to other state agencies" on the statement of net assets in the period for which the liability applies.

NOTES TO FINANCIAL STATEMENTS

Compensated Absences Payable

Annual Leave: WSI employees accrue vested annual leave at a variable rate based on years of service. The amount of annual leave earned ranges between 1 and 2 days per month, and is fixed by the employing unit per section 54-06-14 of the North Dakota Century Code. Accrued annual leave cannot exceed 30 days at April 30 of each year. Employees are paid for unused annual leave upon termination or retirement.

Sick Leave: WSI employees accrue sick leave at the rate of one working day per month of employment without limitation on the amount that can be accumulated. Per North Dakota Century Code section 54-06-14, employees vest at 10 years of continuous service at which time the State is liable for 10 percent of the employee's accumulated unused sick leave.

WSI's liability for accumulated unpaid annual leave and sick leave is reported in the enterprise fund, and will be funded by WSI's appropriation when the liability is to be liquidated. The net change in the liability is recorded as an adjustment to other administrative expenses within the enterprise fund.

Unearned Premium

Premiums are billed to the employer at the beginning of the employer's policy year. The billed premium is recognized as revenue on a straight-line basis over the applicable year. Unearned premiums consist of the unamortized portion of premiums at WSI's year-end.

Unpaid Loss and Loss Adjustment Expenses (LAE)

The liability for unpaid loss and loss adjustment expenses (LAE) is estimated by WSI's actuary, taking into consideration past experience of WSI in paying claims and the general conditions of the environment in which WSI operates. This liability is based on the estimated ultimate costs to settle both reported and incurred but not reported (IBNR) losses and LAE, and includes the effects of inflation and other societal and economic factors. The actuarial computations also include a 5% discount to report this liability at its estimated present value.

Management believes the estimated liability for unpaid loss and LAE is sufficient to cover the ultimate net costs of incurred losses, but such loss reserves are necessarily based on estimates and the ultimate liability may be greater or less than the amounts estimated. Any adjustments to this estimated liability are reflected as part of current operations.

Reclassifications

Certain accounts in the prior year have been reclassified for comparative purposes to conform to the presentation in the current year. Specifically, prior year operating gain was presented net of dividend credit expense. Management has determined that this expense would be better presented under the Nonoperating Revenues (Expenses) section of the Statement of Revenues, Expenses and Changes in Fund Net Assets, as the declaration of a dividend is a legislatively mandated function and not a function of Workforce Safety & Insurance's underwriting activities. This change in presentation has no effect on net assets.

NOTE 2 – RECONCILIATION FROM APPROPRIATIONS TO GAAP REPORTING

Because accounting principles applied for purposes of developing data on an appropriations basis differ from those used to present financial statements in conformity with GAAP, a reconciliation of the expenses on an appropriations basis to the expenses on a GAAP basis for Enterprise Fund administrative expenses for the years ended June 30, 2011 and 2010 are presented below:

NOTES TO FINANCIAL STATEMENTS

	2011	2010
Administrative expenses on an appropriations basis	\$ 32,457,954	\$ 30,430,784
Reconciling adjustments		
Fixed asset additions	(4,559,873)	(2,426,432)
Payroll and benefits	(16,668,282)	(16,094,038)
Unallocated loss adjustment expense	(7,171,522)	(6,892,286)
Increase in compensated absences payable	111,453	91,256
Sublease revenue	(2,296)	(2,396)
Increase in administrative payable	618,823	235,805
Decrease in prepaid expenses	(425,914)	(534,649)
Refund of prior biennium expenses	-	(8,032)
All states premium	-	(184,387)
Ceded reinsurance premium	(3,054,205)	(736,400)
Administrative expenses on a GAAP basis	<u>\$ 1,306,138</u>	<u>\$ 3,879,225</u>

NOTE 3 – CASH DEPOSITS AND INVESTMENT SECURITIES

Deposits

WSI is required to have all funds deposited at the Bank of North Dakota in accordance with North Dakota Century Code (NDCC) 6-09-07.

Custodial credit risk for deposits is the risk that, in the event of the failure of a depository financial institution, WSI will not be able to recover deposits that are in the possession of an outside party. WSI does not have a formal policy that limits custodial credit risk for deposits. All of WSI's cash deposits are uncollateralized. The carrying amount of WSI's cash deposits were \$1,668,707 on June 30, 2011 and \$1,364,416 on June 30, 2010. Bank balances for June 30, 2011 and June 30, 2010, were \$4,627,589 and \$4,216,290, respectively. These monies are deposited in the Bank of North Dakota and are guaranteed by the State of North Dakota under NDCC 6-09-10.

Investments

The fair value of WSI's investments for June 30, 2011 and 2010 is as follows:

	2011	2010
Fair value of investments		
Domestic equity securities	\$ 180,521,510	\$ 146,640,467
International equity securities	96,093,407	77,749,203
Fixed income	959,797,550	901,173,071
Real estate	82,953,635	65,242,803
Cash pool	24,451,437	13,881,811
Securities lending collateral	12,070	7,257,842
Total	<u>\$ 1,343,829,609</u>	<u>\$ 1,211,945,197</u>

NOTES TO FINANCIAL STATEMENTS

WSI is required to use the North Dakota State Investment Board (SIB) for its investing activities. The State Investment Board directs the activities of the North Dakota Retirement and Investment Office (RIO) in order to manage the day to day operations of the fund. The SIB and RIO exercise the prudent investor rules as described in NDCC 21-10-07.

The SIB administers the portfolio according to WSI's investment allocation policy. The SIB selects money managers and monitors performance on a continual basis. WSI updated its investment allocation in fiscal year 2010 to a mix with 13% in domestic equity, 7% in international equity, 51% in domestic fixed income, 22% in inflation protected assets, 6% in real estate, and 1% in cash equivalents.

WSI's investment policy does not address credit risk, custodial credit risk, concentration of credit risk, interest rate risk, or foreign currency risk.

Credit Risk

WSI is invested in an external investment pool managed by the SIB. The pool is not rated.

The following investments represent 5 percent or more of total investments as of June 30, 2011 and 2010:

INVESTMENT	FAIR VALUE JUNE 2011	%	FAIR VALUE JUNE 2010	%
Domestic Fixed Income				
Western Asset	\$ 243,120,636	18.0%	\$ 213,997,336	17.6%
Bank of ND	97,073,145	7.2%	93,533,200	7.7%
Wells Capital	241,712,279	17.9%	226,749,046	18.7%
Inflation Protected Assets				
Western Asset	177,173,275	13.1%	157,578,394	13.0%
Real Estate				
JP Morgan	82,953,667	6.1%	65,780,841	5.40%

Interest Rate Risk

The SIB has chosen to use the Segmented Time Distribution disclosure method. A table detailing WSI's portion of the investment pool is reported below. Readers may refer to the RIO financial statements regarding highly sensitive securities that are disclosed at the SIB level.

NOTES TO FINANCIAL STATEMENTS

Segmented Time Distribution Duration (in thousands)	Fair Value	Less Than 1 year	1-6 Years	6-10 Years	Over 10 years	Not Determined
Asset backed securities	\$ 23,747	\$ -	\$ 3,524	\$ 2,441	\$ 17,782	\$ -
Bank loans	1,067	-	694	373	-	-
Commercial mortgage- backed	24,069	-	662	-	23,407	-
Guaranteed fixed income	3,379	260	3,119	-	-	-
Corporate bonds	336,412	8,813	108,717	118,958	99,924	-
Corporate convertible bonds	2,790	-	2,790	-	-	-
Government agencies	33,209	349	18,278	6,706	7,876	-
Government bonds	92,596	865	37,503	27,329	26,899	-
Government mortgage & commercial backed	45,767	495	937	7,941	36,394	-
Index linked government bonds	1,554	-	-	-	1,554	-
Municipal/provincial bonds	10,300	418	2,830	497	6,555	-
Nongovernmental backed CMO's	14,140	-	-	1,748	12,392	-
Other fixed income	657	430	227	-	-	-
Short term bills and notes	9,451	9,451	-	-	-	-
Pooled investments	278,414	-	7,739	270,675	-	-
Total debt securities	<u>\$877,552</u>	<u>\$21,081</u>	<u>\$ 187,020</u>	<u>\$ 436,668</u>	<u>\$ 232,783</u>	<u>\$ -</u>

(continued on next page)

NOTES TO FINANCIAL STATEMENTS

Foreign Currency Risk

WSI is invested in an external investment pool managed by the SIB. A table detailing WSI's portion of the investment pool is reported below.

Foreign Currencies (in thousands)	Short Term	Debt	Equity	Total
Australian dollar	\$ 254	\$ -	\$ 4,150	\$ 4,404
Brazilian real	-	-	57	57
British pound sterling	20	-	14,157	14,177
Canadian dollar	410	-	1,697	2,107
Czech koruna	360	-	-	360
Israeli shekel	1	-	514	515
Danish krone	12	-	624	636
Euro	(78)	158	23,149	23,229
Hong Kong dollar	5	-	2,778	2,783
Hungarian forint	498	-	-	498
Japanese yen	(16)	-	15,002	14,986
Malaysian Ringgit	-	-	53	53
Mexican peso	183	323	-	506
New Zealand dollar	381	-	-	381
Norwegian krone	489	-	841	1,330
Polish zloty	221	153	126	500
Singapore dollar	500	-	597	1,097
South African rand	267	111	-	378
South Korean won	-	-	891	891
Swedish krona	541	-	1,407	1,948
Swiss franc	206	-	5,814	6,020
Turkish lira	(400)	399	-	(1)
Total securities subject to foreign currency risk	<u>\$ 3,854</u>	<u>\$ 1,144</u>	<u>\$71,857</u>	<u>\$76,855</u>

Securities Lending

GASB Statement No. 28, "Accounting and Financial Reporting for Securities Lending Transactions," establishes accounting and financial reporting standards for securities lending transactions. The standard requires governmental entities to report securities lent as assets in their balance sheets. Cash received as collateral and investments made with that cash must also be reported as assets. The statement also requires the costs of the securities lending transactions to be reported as expenses separately from income received. In addition, the statement requires disclosures about the transactions and collateral related to them.

The investment pool managed by the North Dakota Retirement and Investment Office, which manages WSI's investments, enters into security lending transactions. Securities are loaned versus collateral that may include cash, U.S. government securities and irrevocable letters of credit. U.S. securities are loaned versus collateral valued at 102% of the fair value of the securities plus any accrued interest. Non-U.S. securities are loaned versus collateral valued at 105% of the fair value of the securities plus any accrued interest.

NOTES TO FINANCIAL STATEMENTS

The State Investment Board (SIB) lends its securities to broker-dealers and other entities with a simultaneous agreement to return the collateral for the same securities in the future. The SIB contracted with a third party securities lending agent (Agent) to lend the SIB's securities portfolios. This relationship was terminated by the SIB at its May 20, 2011, meeting. The Agent was requested to call back all securities on loan and liquidate the collateral in a timely yet orderly fashion. All but one loan was recalled and collateral liquidated as of June 30, 2011.

As of June 30, 2011, the fair value of the securities on loan totaled approximately \$12,070. This compares to the total fair value of \$6,939,949 on June 30, 2010. As of June 30, 2011, the total amount of cash and non-cash collateral related to these lent securities was \$39 compared to the total of \$7,257,842 on June 30, 2010.

Indemnification deals with the situation in which a client's securities are not returned due to the insolvency of a borrower and ClearLend (Securities Lending Agent for RIO) has failed to live up to its contractual responsibilities relating to the lending of those securities. ClearLend, (a division of Wells Fargo), has responsibilities which include performing appropriate borrower and collateral investment credit analyses, demanding adequate types and levels of collateral, and complying with applicable Department of Labor and Federal Financial Institutions Examination Council regulations concerning securities lending. ClearLend indemnifies the System if the borrowers fail to return the underlying securities (and if the collateral is inadequate to replace the securities lent) or fail to pay income distributions on them.

The average duration of the collateral investments as of June 30, 2010 was 1 day. The average weighted maturity of collateral investments as of June 30, 2010 was 1 day. Interest rate sensitivity, (duration) of the securities on loan matched the duration of the collateral investments.

The Agent provides indemnification if the borrowers fail to return the underlying securities (and if the collateral is inadequate to replace the securities lent) or fails to pay income distributions on them. All open securities loans can be terminated on demand by either WSI or the borrower. All term securities loans can be terminated with five days notice by either WSI or the borrower. Cash collateral is invested in accordance with the investment guidelines approved by WSI. WSI cannot pledge or sell collateral securities received unless the borrower defaults.

For securities loaned at year end, WSI has no credit risk exposure to borrowers because the amounts WSI owes the borrowers exceed the amounts the borrowers owe WSI.

NOTE 4 – SIGNIFICANT CONCENTRATIONS OF CREDIT RISK

WSI extends short-term credit to its customers, of whom most are located within the state of North Dakota.

NOTES TO FINANCIAL STATEMENTS

NOTE 5 – CAPITAL ASSETS

A statement of changes in capital assets for the years ended June 30, 2011 and 2010 are as follows:

	Balance July 1, 2010	Additions	Deletions	Balance June 30, 2011
Capital assets, not being depreciated				
Land	\$ 901,974	\$ -	\$ -	\$ 901,974
Construction in progress	9,425,985	4,500,731		13,926,716
Total capital assets, not being depreciated	<u>10,327,959</u>	<u>4,500,731</u>	<u>-</u>	<u>14,828,690</u>
Capital assets, being depreciated				
Building	11,001,350	-	-	11,001,350
Furniture and equipment	1,659,882	59,142	(21,670)	1,697,354
Less accumulated depreciation for				
Building	(1,537,741)	(220,027)	-	(1,757,768)
Furniture and equipment	(1,599,150)	(36,789)	21,670	(1,614,269)
Total capital assets, being depreciated, net	<u>9,524,341</u>	<u>(197,674)</u>	<u>-</u>	<u>9,326,667</u>
Total capital assets, net	<u>\$ 19,852,300</u>	<u>\$ 4,303,057</u>	<u>\$ -</u>	<u>\$ 24,155,357</u>
	Balance July 1, 2009	Additions	Deletions	Balance June 30, 2010
Capital assets, not being depreciated				
Land	\$ 901,974	\$ -	\$ -	\$ 901,974
Construction in progress	7,010,559	2,415,426		9,425,985
Total capital assets, not being depreciated	<u>7,912,533</u>	<u>2,415,426</u>	<u>-</u>	<u>10,327,959</u>
Capital assets, being depreciated				
Building	11,001,350	-	-	11,001,350
Furniture and equipment	1,666,306	11,006	(17,430)	1,659,882
Less accumulated depreciation for				
Building	(1,317,714)	(220,027)	-	(1,537,741)
Furniture and equipment	(1,582,008)	(34,572)	17,430	(1,599,150)
Total capital assets, being depreciated, net	<u>9,767,934</u>	<u>(243,593)</u>	<u>-</u>	<u>9,524,341</u>
Total capital assets, net	<u>\$ 17,680,467</u>	<u>\$ 2,171,833</u>	<u>\$ -</u>	<u>\$ 19,852,300</u>

NOTE 6 – DUE FROM (TO) OTHER STATE AGENCIES

The following is a detail of amounts due from other State of North Dakota agencies at June 30, 2011 and 2010.

DUE FROM	2011	2010
North Dakota Child Support	\$ -	\$ 8,794
North Dakota Provider Audit	-	1,777
North Dakota Land Department	-	35
	<u>\$ -</u>	<u>\$ 10,606</u>

NOTES TO FINANCIAL STATEMENTS

The following is a detail of amounts due to other State of North Dakota agencies at June 30, 2011 and 2010:

DUE TO	2011	2010
Central Services	\$ -	\$ 3,831
Information Technology	94,333	66,739
Office of Administrative Hearing	12,727	4,751
Office of the Attorney General	325	-
Office of Management & Budget	94,149	1,898
PERS	60	1,655
Total	<u>\$ 201,594</u>	<u>\$ 78,874</u>

NOTE 7 – UNPAID LOSS AND LOSS ADJUSTMENT EXPENSES (LAE)

An independent actuarial review of WSI's liability for unpaid loss and loss adjustment expenses was conducted for the years ended June 30, 2011 and 2010. The actuarial computations for unpaid loss and LAE include a 5% discount to report this liability at its estimated present value.

For the year ended June 30, 2011 and 2010, the actuary presented an estimate in the form of a range to emphasize the uncertainty which is typical for a "long-tailed" liability insurer such as workers' compensation. Amounts stated are net of reinsurance. Ranges are displayed in thousands.

FY 2011	Low	Expected Value	High
Full value basis, undiscounted	\$ 1,299,767	\$ 1,360,619	\$ 1,493,369
Present value basis, discounted at 5%	776,081	814,023	892,190

WSI recorded the actuary's estimate for unpaid loss and LAE of \$814,023,000.

FY 2010	Low	Expected Value	High
Full value basis, undiscounted	\$ 1,206,339	\$ 1,313,946	\$ 1,450,670
Present value basis, discounted at 5%	708,430	772,095	851,902

WSI recorded the actuary's estimate for unpaid loss and LAE of \$772,095,000.

NOTES TO FINANCIAL STATEMENTS

WSI establishes a liability for both reported and incurred but not reported (IBNR) losses, which includes estimates of both future payments of losses and the related loss adjustment expenses, both allocated and unallocated. A reconciliation of the changes in unpaid loss and LAE during the past two years is shown as follows:

	(In Thousands)	
	2011	2010
Beginning balance	\$ 772,095	\$ 771,900
Incurred losses and loss adjustment expenses (LAE)		
Provision for current fiscal year	191,795	160,265
Change in provision for prior fiscal years	(20,540)	(26,657)
Payments attributable to		
Current fiscal year	(38,596)	(30,861)
Prior fiscal years	(85,686)	(82,601)
Change in provision for liability discount	(5,045)	(19,951)
Ending balance	\$ 814,023	\$ 772,095

NOTE 8 – REINSURANCE

In accordance with NDCC Sections 65-02-13 and 65-02-13.1, WSI obtained reinsurance coverage with Munich Re America, formerly American Re-Insurance Company. The contracts for reinsurance were in effect for all losses incurred on or after December 1, 1999 through November 30, 2002. Under the reinsurance contract, Munich Re America agrees to reimburse WSI on an excess of loss basis.

WSI's annual reinsurance premium for the three year coverage period beginning December 1, 1999 and ending November 30, 2002 was \$1.1 million, \$1.1 million, and \$2.5 million respectively. WSI's retention for losses incurred between December 1, 1999 and November 30, 2001 is \$500,000. For losses incurred from December 1, 2001 through November 30, 2002, WSI's retention is \$1,000,000. The cumulative amounts recovered on paid losses at June 30, 2011 and 2010 were \$5.6 million and \$5 million respectively. The amounts recoverable on pending losses at June 30, 2011 and 2010 were \$30.4 million and \$27.6 million respectively.

In 2002, global influences such as the 9-11 attacks hardened the reinsurance market and pushed the price of reinsurance to an inefficient level. As a result, WSI withdrew from the reinsurance market until recently. In 2009, WSI issued a RFP to determine if reinsurance was again practical. Working with an intermediary, Guy Carpenter, WSI re-entered the reinsurance market with catastrophic coverage effective January 1, 2010, offering protection for losses occurring during the 2010 calendar year that exceed the first layer of reinsurance at \$5 as well as the second \$10 million dollar layer.

In 2011, WSI renewed its contract with the reinsurance intermediary, Guy Carpenter, and purchased three layers of catastrophic coverage for losses occurring during calendar year 2011. The first layer is for claims that exceed \$3 million dollars; the second layer for claims that exceed \$5 million and the third layer for claims which exceed the \$10 million. Terms, limits, and pricing are re-evaluated annually.

NOTES TO FINANCIAL STATEMENTS

NOTE 9 – ALL STATES COVERAGE

WSI is the sole provider of workers' compensation coverage in North Dakota and insures employers for work related injuries. A North Dakota employer that operates outside of the state may be at risk for claims filed in another jurisdiction. As a solution, in September 2004, WSI contracted with the Accident Fund of America to provide "temporary and incidental" coverage for North Dakota employers who operate outside the state on an incidental basis. Effective July 1, 2010, the program was expanded to include all North Dakota policyholders at no charge to the individual policyholder.

NOTE 10 – OPERATING LEASES

WSI has entered into various operating leases for office space and equipment. Leases contain a clause allowing for termination with a 90-120 day notice and a clause stating that renewal is dependent on appropriation funding by the State Legislature. Expenditures for operating leases were \$163,886 for fiscal year 2011 and \$166,289 for fiscal year 2010.

The following is a schedule of future minimum lease payments required under the operating leases.

Year Ending June 30	
2012	\$ 176,252
2013	176,252
2014	55,821
2015	40,409
	<u>\$ 448,734</u>

NOTE 11 – LONG-TERM LIABILITIES

Compensated Absences Payable

WSI employees can earn annual leave at a variable rate based on years of service. The amount of annual leave earned ranges between 1 and 2 days per month and accrued annual leave cannot exceed 30 days as of April 30th of each year. WSI employees earn sick leave at the rate of one working day per month of employment without limitation on the amount that can be accumulated. At 10 years of continuous service, the State is liable for 10 percent of the employee's accumulated unused sick leave.

The reported liabilities for compensated absences were \$1,186,912 and \$1,075,459 on June 30, 2011, and June 30, 2010 respectively. This balance includes the employer's share of FICA taxes.

	FY 2011 Beginning Balance	Additions	Reductions	FY 2011 Ending Balance	Amount Due Within One Year
Other long-term liabilities					
Compensated absences	<u>\$ 1,075,459</u>	<u>\$ 963,553</u>	<u>\$ 852,100</u>	<u>\$ 1,186,912</u>	<u>\$ 1,008,875</u>
	FY 2010 Beginning Balance	Additions	Reductions	FY 2010 Ending Balance	Amount Due Within One Year
Other long-term liabilities					
Compensated absences	<u>\$ 984,203</u>	<u>\$ 997,823</u>	<u>\$ 906,567</u>	<u>\$ 1,075,459</u>	<u>\$ 914,140</u>

WSI's employee turnover rate for fiscal year 2011 and 2010 were 4.6% and 2.2% respectively.

NOTES TO FINANCIAL STATEMENTS

NOTE 12 – PENSION PLANS

WSI participates in the North Dakota Public Employees Retirement System (PERS) administered by the State of North Dakota. The following is a brief description of the plans.

Defined Benefit Pension Plan

PERS is a cost-sharing multiple-employer defined benefit pension plan covering most classified employees of the WSI. The plan provides retirement, disability and death benefits. If an active employee dies with less than three years of credit service, a death benefit equal to the value of the employees' accumulated contributions, plus interest, is paid to the employee's beneficiary. If the employee has earned more than three years of credited service, the surviving spouse will be entitled to a single payment refund, life-time monthly payments in an amount equal to 50% of the employee's accrued normal retirement benefit, 60 monthly payments equal to the employee's accrued normal retirement benefit calculated as if the employee were age 65 the day before death occurred or monthly payments in an amount equal to the employee's accrued 100% joint and survivor retirement benefit if the member had reached normal retirement age prior to date of death. If the surviving spouse dies before the employee's accumulated pension benefits are paid, the balance will be paid to the surviving spouse's designated beneficiary.

Eligible employees who become totally disabled after a minimum of 180 days of service, receive monthly disability benefits that are equal to 25% of their final average salary with a minimum benefit of \$100. To qualify under this section, the employee must meet the criteria established by the Retirement Board for being considered totally disabled.

Employees are entitled to unreduced monthly pension benefits equal to 2.00% of their final average salary for each year of service beginning when the sum of age and years of credit service equal or exceed 85, or at normal retirement age (65). The plan permits early retirement at ages 55-64, with three or more years of service.

Benefit and contribution provisions are administered in accordance with chapter 54-52 of the North Dakota Century Code. This state statute requires that 4% of the participant's salary be contributed to the plan by either the employee or by the employer under a "salary reduction" agreement. WSI has implemented a salary reduction agreement and is currently contributing the employees' shares. WSI is required to contribute 4.12% of each participant's salary as the employer's share. The required contributions are determined using an entry age normal actuarial funding method. The North Dakota Retirement board was created by the State Legislature and is the governing authority of PERS. WSI's required and actual contributions to PERS for the fiscal years ended June 30, 2011, 2010 and 2009, were \$504,099, \$528,019 and \$464,016 respectively.

PERS issues a publicly available financial report that includes financial statements and the required supplementary information for NDPERS. This report may be obtained by writing to: North Dakota Public Employees Retirement System; 400 East Broadway, Suite 505; PO Box 1657, Bismarck, ND 58502-1657.

Defined Contribution Retirement Plan

The North Dakota Defined Contribution Retirement Plan (Plan) is a defined contribution plan administered by the North Dakota Public Employees Retirement System Board. The Plan was established on January 1, 2000, and is administered in accordance with Chapter 54-52.6 of the North Dakota Century Code. The Plan covers state employees who are in positions not classified by the central personnel division of the State of North Dakota. Employees of the judicial branch or the Board of Higher Education and State Institutions under the jurisdiction of the Board of Higher Education are not eligible to participate in the Plan.

NOTES TO FINANCIAL STATEMENTS

Member contributions to the Plan are vested immediately and employer contributions to the Plan made on behalf of the member are 100% vested after four years of service. Contribution rates for the Plan are set by state statute. Member contributions are established at 4 percent and employer contributions are established at 4.12 percent of regular compensation.

Contributions made to the Plan, by the members and WSI, for the years ending June 30, 2011, 2010 and 2009 totaled \$506,356, \$546,396, and \$503,874 respectively.

NOTE 13 – POSTRETIREMENT BENEFITS

Former employees receiving retirement benefits under the Retirement Plan for Employees of WSI are eligible to participate in the Retiree Health Benefits Fund, a cost-sharing multiple-employer plan, as administered by the Public Employees Retirement Board. During each month of employment, WSI contributes a percentage based upon each employee's salary into the Retiree Health Benefits Fund. Total contributions for the fiscal years ending June 30, 2011, 2010 and 2009 were \$138,602, \$116,028, and \$106,126 respectively. The 61st Legislative Assembly increased the contribution percentage from 1.00% to 1.14%, effective August 1, 2009.

NOTE 14 – EMPLOYEE DEFERRED COMPENSATION PLAN

Employees of WSI may participate in an employee deferred compensation plan in accordance with Internal Revenue Service Code Section 457. The plan allows participating employees to defer a portion of their salary until future years. The deferred compensation is not available to the participants until termination, retirement, death, or unforeseeable emergency. The plan is administered by the State of North Dakota Retirement Board. All compensation deferred under the plans, all property and rights purchased with those amounts, and all income attributable to those amounts, property or rights are held in trust for the exclusive use of the employee or their beneficiary.

Since the investments are not held by WSI, the investments and the related obligation to employees is not included in WSI's statement of net assets.

NOTE 15 – RISK MANAGEMENT

WSI is exposed to various risks of loss related to torts; theft of, damage to, and destruction of assets; errors and omissions; injuries to employees; and natural disasters. The following are funds/pools established by the State for risk management issues.

WSI is insured by the State Fire & Tornado Fund as well as the State Bonding Fund. WSI pays an annual premium to the Fire & Tornado Fund for 90% of the replacement cost on its personal property. Replacement cost is estimated on the office building and all furniture and equipment in consultation with the Fire & Tornado Fund. The State Bonding Fund currently provides WSI with blanket fidelity bond coverage in the amount of \$2,000,000 for its employees. The State Bonding Fund does not currently charge any premium for this coverage.

WSI is insured through the OMB Risk Management Division for workers compensation insurance as well as tort liability. WSI pays an annual premium to the OMB Risk Management Division for both of these exposures. The Risk Management Division manages all workers compensation claims for all state agencies.

NOTES TO FINANCIAL STATEMENTS

NOTE 16 – SIGNIFICANT LEGISLATIVE CHANGES

Fiscal year 2010 was a non-legislative year so no new legislation was enacted. The following list indicates significant legislative changes for WSI that were enacted by the 2011 Legislative Assembly.

- 2011 HB 1050 established a vocational rehabilitation grant program.
- 2011 HB 1051 provides up to two years of benefits for workers injured within two years of their presumed retirement date.
- 2011 HB 1055 provides that the organization move from the 5th to 6th edition of the AMA Guides for evaluating impairment awards; reduces the threshold for percentage of whole body impairment to qualify for a PPI award; increases permanent partial impairment awards (multipliers) for the lower impairment levels; and increases the PPI benefit rate.
- 2011 HB 1056 requires the independent performance evaluation conducted by workers' compensation industry experts to be conducted every four years rather than every two years.
- 2011 HB 1453 increases the real estate remodeling allowance from \$50,000 to \$75,000.
- 2011 SB 2021 provided WSI's appropriation for the 2011-13 biennium.
- 2011 SB 2114 expands eligibility for the scholarship program; increases the annual cap that the organization can award in scholarships from \$300,000 to \$500,000; increases the maximum scholarship amount payable per applicant from \$4,000 per year to \$10,000 per year; streamlines the personal reimbursement process for injured workers; and expands eligibility for the educational revolving loan fund.

NOTE 17 – RELATED PARTIES

As stated in Note 1 of these financial statements, WSI is an agency of the state of North Dakota; as such, the other state agencies and political subdivisions are related parties.

NOTE 18 – TENANT LEASES

WSI leases office space to 6 tenants in their main office building at 1600 East Century Avenue, Bismarck, ND. These six tenants, identified below, began leasing space at WSI's Century Center on July 1, 2003. All tenants had an increase in their lease rates on July 1, 2007 and again on July 1, 2011. All tenants have renewed their leases with a term of July 1, 2011 through June 30, 2013 as provided below:

	Monthly Rent	Annual Rent
ND Council on the Arts	\$ 1,607	\$ 19,280
ND Department of Commerce	19,162	229,941
ND Human Services Child Support	9,433	113,194
ND Human Services Provider Audit	1,909	22,910
ND OMB Risk Management	1,869	22,425
ND Parks & Recreation	6,873	82,472
Total	<u>\$ 40,853</u>	<u>\$ 490,222</u>

NOTES TO FINANCIAL STATEMENTS

NOTE 19 – FINANCIAL RESERVES AND SURPLUS

NDCC 65-04-02 requires WSI to maintain adequate financial reserves plus surplus of at least 120% to a maximum of 140% of the actuarial established discounted reserve. Should WSI's available surplus be outside of these levels, statute allows WSI two years to come into compliance. However, statute restricts WSI from granting a dividend credit of greater than 50% of prior years premium.

The 2009 Legislative Assembly modified this statute via 2009 HB1035. The legislation defined "available surplus" as net assets excluding funds designated or obligated to specific programs or projects pursuant to a directive or specific approval by the legislative assembly. This legislation also set parameters on when a dividend declaration should and should not be considered.

WSI's available surplus of \$366,653,388 plus discounted reserve liabilities on June 30, 2011 equals 145% of the actuarial discounted reserve of \$814,023,000. This compares to available surplus of \$306,036,907 plus discounted reserve liabilities on June 30, 2010 which equal 139.6% of the actuarial discounted reserve of \$772,095,000. While the June 30, 2011 available surplus total of \$366,653,388 is outside the 140% statutory surplus requirement level, WSI is still in compliance as WSI did grant the maximum dividend credit of 50% to be applied to the 2011-12 policy year.

(In Thousands)

SURPLUS REVIEW		June 30, 2010		June 30, 2011	
Estimated Discounted Financial Reserves		\$ 772,095	100%	\$ 814,023	100%
-					
Net Assets (Surplus)		\$ 336,211	43.5%	\$ 393,128	48.3%
Minimum Limit - 20% of actuarial discounted financial reserve estimate		154,419	20.0%	162,805	20.0%
Maximum Limit - 40% of actuarial discounted financial reserve estimate		308,838	40.0%	325,609	40.0%
Surplus amount exceeding 40% maximum		27,373	3.5%	67,519	8.3%
2009 HB 1035 Allowable Deductions from Net Assets (Surplus)					
Safety & Education Grants		10,638		8,561	
Revolving School Loan Fund		14,954		14,878	
ITTP Update		4,582		3,036	
Total Deductions from Net Assets (Surplus)		30,174	3.9%	26,475	3.3%
Available Fund Surplus		\$ 306,037	39.6%	\$ 366,653	45.0%
Discounted Financial Reserves + Available Surplus		\$ 1,078,132	139.6%	\$ 1,180,676	145.0%

NOTES TO FINANCIAL STATEMENTS

NOTE 20 – CONTINUING APPROPRIATIONS

The following information discloses WSI's continuing appropriation authority of funding from the workers' compensation fund. WSI does not receive any general fund dollars.

NDCC 65-02-30 Performance Evaluation - This statute requires a performance evaluation be conducted on WSI operations every other biennium through the coordination of the State Auditor's Office. Funding is provided through a continuing appropriation.

NDCC 65-02-05.1 Building Operations - Workforce Safety & Insurance manages the day-to-day operations and maintenance of the building, such as utilities, janitorial service and grounds keeping. These operations are funded from continuing appropriations.

NDCC 65-02-13.1 Other States Coverage - An amount necessary to allow the organization to establish a program of reinsurance and a program of extraterritorial coverage and other states' insurance is to be appropriated out of the Workforce Safety & Insurance Fund, as a continuing appropriation. The organization may execute a contract for reinsurance and a contract for extraterritorial coverage and other states' insurance binding on the organization and the contracting party.

NDCC 54-06-29 Collection Agency Fees - WSI maintains an internal collections unit to manage its premium receivable. From time to time, after all collection efforts have been exhausted, account balances are written off for non-payment. A few of these account balances are then turned over to external collection agencies. This continuing appropriation is addressed in OMB Fiscal and Administrative Policy 212. The dollars reported are the fees paid to collection agencies for amounts recovered.

NDCC 65-03-04 Safety Programs - The 2005 Legislative Assembly authorized a continuing appropriation for promoting safety through education, training, consultation, grants and other incentives. WSI's loss control employees and their related administrative expenses are not included as part of this continuing appropriation; thus the expenditures include only those items that are a direct benefit to WSI's customers and North Dakota's workforce.

NDCC 65-05-36 Preferred Worker Program - WSI established a program for injured workers who, while employable, are unable to return to the employer at the time of their injury. The preferred worker program offers benefits to North Dakota employers for hiring people under this program. This continuing appropriation funds any employment-related expenses such as equipment purchases and work-site modifications for the preferred worker.

NDCC 65-02-23 Insurance Fraud – This statute authorizes a continuing appropriation for "costs associated with identifying, preventing and investigating employer and provider fraud." Injured worker fraud expenses are charged directly to the claim as allocated loss adjustment expenses. WSI's special investigations unit (SIU) works to investigate and prevent insurance fraud by employers, medical providers and injured workers.

NOTE 21 – COMMITMENT

WSI has entered into contracts with multiple companies for a software system replacement project. The estimated total cost for these contracts is \$17.7 million, of which \$13.9 million has been expended as of June 30, 2011. This amount is included in construction in progress.

The original project budget through the biennium ending June 30, 2011 was \$14 million. It was expected that another \$800,000 would be spent during the 2009-11 biennium for a project total of \$14.8. WSI planned to find those funds within the budget for that biennium.

NOTES TO FINANCIAL STATEMENTS

It is anticipated another \$3.8 million will be expended to complete this project. WSI requested and was granted an additional \$3 million by the Gubernatorial Budget Process and the 2011 Legislative Assembly for this computer system replacement project. The \$800,000 remaining funds needed to complete the project will be found within the existing budget for this biennium.

NOTE 22 – CONTINGENCY

In February 2009, the State Investment Board (SIB) was notified of legal action being taken against one of its investment advisors. The principals of WG Trading Company, the broker/dealer for the Westridge Capital Management portfolios, were charged with securities fraud for allegedly diverting investor funds for their personal use. The SIB was an investor along with numerous other public and private pension funds.

Potential investors were offered two options: invest directly in WG Trading Company (WGTC) by purchasing a limited partnership interest in it; or lend money to WG Trading Inc. (WGTI). WGTC was subject to SEC regulations, capital requirements, and reporting and oversight; whereas WGTI was an unregulated and unaudited entity. SIB chose to invest directly in the regulated, audited WGTC.

At the time the Commodity Futures Trading Commission (CFTC) and Securities and Exchange Commission (SEC) charges were filed, the court appointed a receiver to take control of any recoverable assets. The receiver recommended the court distribute the recovered assets as follows: pool the assets of WGTC and WGTI, and distribute those assets *pro rata* to all investors. The receiver's method did not take into consideration the terms in which each investor entered into the investment (i.e. limited partnership interest versus note holder agreement), even though the majority of the WGTC assets were intact and the fraud predominantly occurred with WGTI. The court agreed with the receiver's distribution plan and in April, 2011, the recovered assets were distributed to all investors in a *pro rata* distribution based on net investment balances. The SIB received a total distribution of \$63.9 million, which represented approximately 85% of its remaining cost basis with WGTC. WSI's remaining investment was approximately \$12.5 million and WSI's share of this distribution was \$10.6 million. WSI's realized loss of \$1.9 million is included in the June 30, 2011 financial statements.

The SIB did not agree with the method used to distribute the assets and joined the other limited partners in appealing the District Court's ruling. It is the SIB's position that the District Court incorrectly determined the amount of the distribution; and that the audited limited partners are entitled to a greater share of the recovered assets than the unaudited note holders. At this time it is difficult to estimate the potential additional distribution that could be received if the appeal is successful, therefore, no amount has been included on the balance sheet as of June 30, 2011.

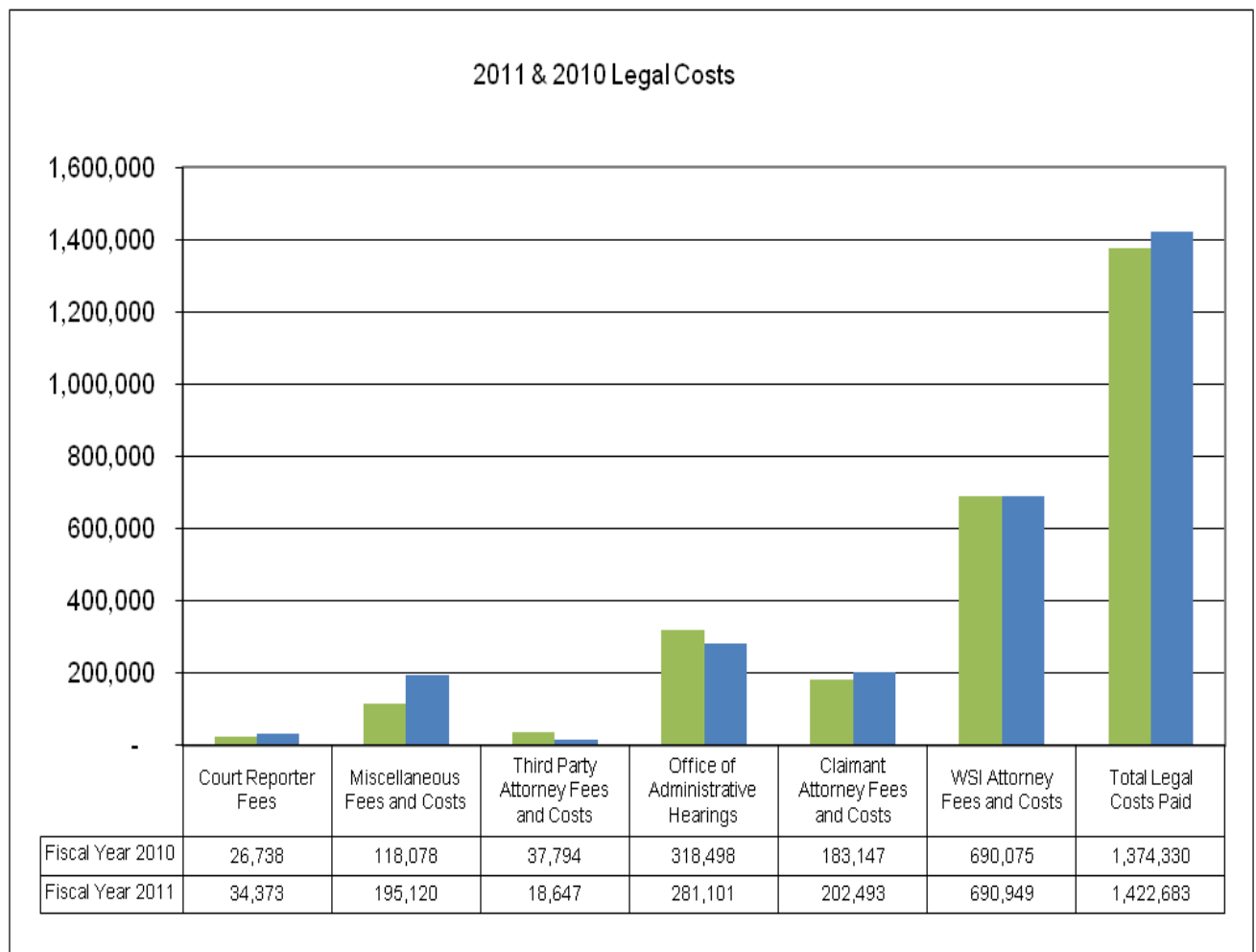
WORKFORCE SAFETY & INSURANCE
REQUIRED SUPPLEMENTARY INFORMATION
LOSS DEVELOPMENT INFORMATION
JUNE 30, 2011

The table below illustrates how the Fund's earned revenues and investment income compare to related costs of loss and other expenses assumed by the Fund as of the end of each of the last ten years. The rows of the table are defined as follows: (1) This line shows the total of each fiscal year's earned contribution revenues and investment revenues. (2) This line shows each fiscal year's other operation costs of the Fund including overhead and claims expense not allocable to individual claims, as well as investment expenses. (3) This line shows the Fund's incurred losses and allocated loss adjustment expenses, both paid and accrued, as originally reported at the end of the first year in which the event that triggered coverage under the contract occurred (referred to as policy year). (4) This section of 10 rows shows the cumulative amounts paid at the end of successive years for each policy year. (5) This section of 10 rows shows how each policy years' estimated incurred losses increased or decreased at the end of each successive year. This annual re-estimation is the result of new information received regarding unknown claims, re-evaluation of existing information on known claims, as well as the emergence of new claims not previously known. (6) This line compares the latest re-estimated incurred losses amount to the amount originally established (line 3) and shows whether this latest estimate of claims cost is greater or less than the original. As data for individual policy years mature, the correlation between original estimates and re-estimated amounts is commonly used to evaluate the accuracy of incurred losses currently recognized in less mature policy years. The columns of the table show data for successive policy years.

	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011
1. Net earned required contribution and investment revenues	\$ 85,553	\$ 175,459	\$ 194,499	\$ 193,237	\$ 148,161	\$ 220,949	\$ 165,637	\$ 48,033	\$ 288,949	\$357,172
2. Unallocated expenses	23,030	22,301	20,612	25,351	33,023	40,011	40,662	30,944	32,709	29,997
3. Estimated incurred claims and expense, end of policy year	80,567	92,605	102,960	110,710	105,264	120,109	131,380	168,964	160,265	191,795
4. Paid (cumulative) as of										
End of policy year	17,131	18,586	20,379	22,156	20,511	20,985	26,584	32,054	30,861	38,596
One year later	29,843	32,776	36,106	34,447	35,796	37,151	46,708	54,795	52,410	
Two years later	36,524	37,938	41,503	39,012	41,392	43,292	53,511	63,358		
Three years later	41,233	40,884	45,710	42,288	45,829	47,083	57,571			
Four years later	43,438	43,501	48,890	45,200	49,386	50,343				
Five years later	46,520	45,956	52,015	47,689	52,689					
Six years later	48,050	48,329	54,230	49,784						
Seven years later	52,151	50,352	56,138							
Eight years later	54,444	52,077								
Nine years later										
5. Re-estimated incurred claims and expense										
End of policy year	80,567	92,605	102,960	110,710	105,264	120,109	131,380	168,964	160,265	191,795
One year later	83,597	93,920	103,130	104,186	112,278	119,100	140,328	157,106	151,411	
Two years later	83,419	92,680	98,620	99,532	113,408	120,358	132,931	153,098		
Three years later	88,494	88,587	100,363	100,733	116,475	110,135	128,652			
Four years later	86,009	90,270	105,675	100,789	109,622	107,711				
Five years later	89,752	91,030	104,774	101,405	110,026					
Six years later	91,029	91,937	104,216	98,409						
Seven years later	98,352	93,926	103,287							
Eight years later	100,956	93,086								
Nine years later	101,133									
6. Change in estimated incurred claims and expense from end of policy year	20,566	\$ 481	\$ 327	\$ (12,301)	\$ 4,762	\$ (12,398)	\$ (2,728)	\$ (15,866)	\$ (8,854)	\$ -

WORKFORCE SAFETY & INSURANCE
SCHEDULE OF ATTORNEY FEES AND COSTS
JUNE 30, 2011 AND 2010

Pursuant to Section 65-02-06.1 of the NDCC, the following chart shows the breakdown of allocated loss adjustment expenses (ALAE) for legal fees and costs paid to attorneys representing both the injured workers and WSI, amounts paid for administrative law judges through the Office of Administrative Hearings, court reporter fees, and other miscellaneous legal fees. Legal fees and costs paid in fiscal years 2011 and 2010 were \$1,422,683 and \$1,374,330 respectively. These costs are included as a portion of incurred losses within the “Statements of Revenues, Expenses and Changes in Fund Net Assets” of this report.





CERTIFIED PUBLIC ACCOUNTANTS
AND CONSULTANTS

**INDEPENDENT AUDITOR'S REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING
AND ON COMPLIANCE AND OTHER MATTERS BASED ON AN AUDIT OF FINANCIAL
STATEMENTS PERFORMED IN ACCORDANCE WITH *GOVERNMENT AUDITING STANDARDS***

Governor of North Dakota
The Legislative Assembly

The Board of Directors
Workforce Safety & Insurance
Bismarck, North Dakota

We have audited the financial statements of the business-type activities of Workforce Safety & Insurance, as of and for the year ended June 30, 2011, which collectively comprise Workforce Safety & Insurance's basic financial statements and have issued our report thereon dated October 10, 2011. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

Internal Control Over Financial Reporting

In planning and performing our audit, we considered Workforce Safety & Insurance's internal control over financial reporting as a basis for designing our auditing procedures for the purpose of expressing our opinions on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of Workforce Safety & Insurance's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of Workforce Safety & Insurance's internal control over financial reporting.

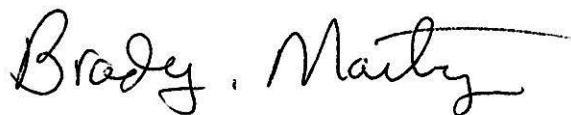
A *deficiency in internal control* exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct misstatements on a timely basis. A *material weakness* is a deficiency, or a combination of deficiencies, in internal control such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected on a timely basis.

Our consideration of internal control over financial reporting was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control over financial reporting that might be deficiencies, significant deficiencies, or material weaknesses. We did not identify any deficiencies in internal control over financial reporting that we consider to be material weaknesses, as defined above.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether Workforce Safety & Insurance's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*.

This report is intended solely for the information and use of the audit committee, Legislative Audit and Fiscal Review Committee, management, and other state officials, and is not intended to be and should not be used by anyone other than these specified parties.

A handwritten signature in black ink, reading "Brady, Martz". The signature is written in a cursive, flowing style with a horizontal line extending from the end.

BRADY, MARTZ & ASSOCIATES, P.C.

October 10, 2011



CERTIFIED PUBLIC ACCOUNTANTS
AND CONSULTANTS

**INDEPENDENT AUDITOR'S SPECIFIC COMMENTS REQUESTED BY THE
NORTH DAKOTA LEGISLATIVE AUDIT AND FISCAL REVIEW COMMITTEE
YEAR ENDED JUNE 30, 2011**

Board of Directors
Workforce Safety & Insurance
Bismarck, North Dakota

The Legislative Audit and Fiscal Review Committee requires that certain items be addressed by independent certified public accountants performing audits of state agencies. The items and our responses are as follows:

Audit Report Communications:

1. What type of opinion was issued on the financial statements?

An unqualified opinion was issued on the 2011 financial statements.

2. Was there compliance with statutes, laws, rules, regulations under which the agency was created and is functioning?

Yes

3. Was internal control adequate and functioning effectively?

Yes

4. Were there any indications of lack of efficiency in financial operations and management of the agency?

No

5. Has action been taken on findings and recommendations included in prior year audit reports?

No prior year findings.

6. Was a management letter issued? If so, provide a summary below, including any recommendations and the management response.

No

Audit Committee Communications:

- 1. Identify any significant changes in accounting policies, any management conflicts of interest, any contingent liabilities, or any significant unusual transactions.**

None.

- 2. Identify any significant accounting estimates, the process used by management to formulate the accounting estimates, and the basis for the auditor's conclusions regarding the reasonableness of those estimates.**

One of the most significant estimates to the financial statements is the liability for unpaid loss and loss adjustment expenses (LAE). The LAE amount is estimated by WSI's actuary, taking into consideration past experience of WSI in paying claims and the general conditions of the environment in which WSI operates. This liability is based on the estimated ultimate costs to settle both reported and incurred but not reported (IBNR) losses and LAE, and includes the effects of inflation and other societal and economic factors. The actuarial computations also include a 5% discount to report this liability at its estimated present value. Brady Martz has a third party actuary review the estimate by WSI's actuary to ensure the estimate is reasonable.

Another significant estimate to the financial statements is the dividend expense and related liability. The dividend expense and liability is calculated using the policyholder's prior year premium less any safety discounts awarded. This premium is an estimate based upon the previous year's actual payroll, and is subject to change once the current year's actual payroll is known. As that becomes known, and the premiums are adjusted, so too will the dividend liability and expense be adjusted. Brady Martz reviewed the assumptions and calculations used in determining the estimate to ensure the estimate is reasonable.

- 3. Identify any significant audit adjustments.**

None.

- 4. Identify any disagreements with management, whether or not resolved to the auditor's satisfaction, relating to a financial accounting, reporting, or auditing matter that could be significant to the financial statements.**

None.

- 5. Identify any serious difficulties encountered in performing the audit.**

None.

- 6. Identify any major issues discussed with management prior to retention.**

None.

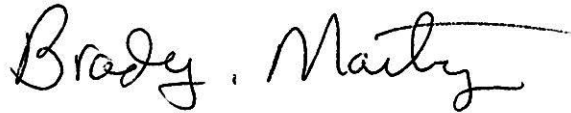
- 7. Identify any management consultations with other accountants about auditing and accounting matters.**

None.

8. Identify any high-risk technology systems critical to operations based on the auditor's overall assessment of the importance of the system to the agency and its mission, or whether any exceptions identified in the six report questions to be addressed by auditors are directly related to the operations of an information technology system.

The Claims Management System (CMS) and Policy Holder Services (PICS) databases have been identified as the most high-risk systems at Workforce Safety & Insurance. There were no exceptions identified that were directly related to this application.

This report is intended solely for the information and use of the North Dakota Industrial Commission, Legislative Audit and Fiscal Review Committee and management, and is not intended to be and should not be used by anyone other than these specified parties.

A handwritten signature in black ink, reading "Brady Martz". The signature is written in a cursive, flowing style with a long horizontal stroke extending from the end of the name.

BRADY, MARTZ & ASSOCIATES, P.C.

October 10, 2011



CERTIFIED PUBLIC ACCOUNTANTS
AND CONSULTANTS

**INDEPENDENT AUDITOR'S COMMUNICATION
TO THE AUDIT COMMITTEE OF WORKFORCE SAFETY & INSURANCE**

To the Audit Committee
Workforce Safety & Insurance
Bismarck, North Dakota

We have audited the financial statements of the business-type activities of Workforce Safety & Insurance, a department of the State of North Dakota for the year ended June 30, 2011. Professional standards require that we provide you with information about our responsibilities under generally accepted auditing standards and *Government Auditing*, as well as certain information related to the planned scope and timing of our audit. We have communicated such information to you on June 14, 2011. Professional standards also require that we communicate to you the following information related to our audit.

Significant Audit Findings

Qualitative Aspects of Accounting Practices

Management is responsible for the selection and use of appropriate accounting policies. The significant accounting policies used by Workforce Safety & Insurance are described in Note 1 to the financial statements. No new accounting policies were adopted and the application of existing policies was not changed during 2011. We noted no transactions entered into by the governmental unit during the year for which there is a lack of authoritative guidance or consensus. All significant transactions have been recognized in the financial statements in the proper period.

Accounting estimates are an integral part of the financial statements prepared by management and are based on management's knowledge and experience about past and current events and assumptions about future events. Certain accounting estimates are particularly sensitive because of their significance to the financial statements and because of the possibility that future events affecting them may differ significantly from those expected. The most sensitive estimates affecting the financial statements were:

One of the most sensitive estimates is the liability for unpaid loss and loss adjustment expenses (LAE). The LAE amount is estimated by WSI's actuary, taking into consideration past experience of WSI in paying claims and the general conditions of the environment in which WSI operates. This liability is based on the estimated ultimate costs to settle both reported and incurred but not reported (IBNR) losses and LAE, and includes the effects of inflation and other societal and economic factors. The actuarial computations also include a 5% discount to report this liability at its estimated present value. Brady Martz has a third party actuary review the estimate by WSI's actuary to ensure the estimate is reasonable.

Another significant estimate to the financial statements is the dividend expense and related liability. The dividend expense and liability is calculated using the policyholder's prior year premium less any safety discounts awarded. This premium is an estimate based upon the previous year's actual payroll, and is subject to change once the current year's actual payroll is known. As that becomes known, and the premiums are adjusted, so too will the dividend liability and expense be adjusted. Brady Martz reviewed the assumptions and calculations used in determining the estimate to ensure the estimate is reasonable.

Difficulties Encountered in Performing the Audit

We encountered no significant difficulties in dealing with management in performing and completing our audit.

Corrected and Uncorrected Misstatements

Professional standards require us to accumulate all known and likely misstatements identified during the audit, other than those that are trivial, and communicate them to the appropriate level of management. Management has corrected all such misstatements. In addition, none of the misstatements detected as a result of audit procedures and corrected by management were material, either individually or in the aggregate, to each opinion unit's financial statements taken as a whole.

Disagreements with Management

For purposes of this letter, professional standards define a disagreement with management as a financial accounting, reporting, or auditing matter, whether or not resolved to our satisfaction, that could be significant to the financial statements or the auditor's report. We are pleased to report that no such disagreements arose during the course of our audit.

Management Representations

We have requested certain representations from management that are included in the management representation letter dated October 10, 2011.

Management Consultations with Other Independent Accountants

In some cases, management may decide to consult with other accountants about auditing and accounting matters, similar to obtaining a "second opinion" on certain situations. If a consultation involves application of an accounting principle to the governmental unit's financial statements or a determination of the type of auditor's opinion that may be expressed on those statements, our professional standards require the consulting accountant to check with us to determine that the consultant has all the relevant facts. To our knowledge, there were no such consultations with other accountants.

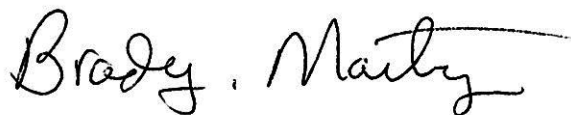
Other Audit Findings or Issues

We generally discuss a variety of matters, including the application of accounting principles and auditing standards, with management each year prior to retention as the governmental unit's auditors. However, these discussions occurred in the normal course of our professional relationship and our responses were not a condition to our retention.

Other Information in Documents Containing Audited Financial Statements

With respect to the supplementary information accompanying the financial statements, we made certain inquiries of management and evaluated the form, content, and methods of preparing the information to determine that the information complies with accounting principles generally accepted in the United States of America, the method of preparing it has not changed from the prior period, and the information is appropriate and complete in relation to our audit of the financial statements. We compared and reconciled the supplementary information to the underlying accounting records used to prepare the financial statements or to the financial statements themselves.

This letter is intended solely for the information and use of the audit committee, Legislative Audit and Fiscal Review Committee, management and other state officials, and is not intended to be and should not be used by anyone other than these specified parties.

A handwritten signature in black ink, reading "Brady, Martz". The signature is written in a cursive, flowing style with a long horizontal line extending from the end.

BRADY, MARTZ & ASSOCIATES, P.C.

October 10, 2011